NATIONAL FORECAST DESCRIPTION

The Forecast Period is the First Quarter of 2002 through the Fourth Quarter of 2005

The U.S. economy is sound and should begin picking up speed during the second half of this year. This may come as a surprise given the current stock market woes and revelations of corporate corruption. Indeed, the recent tremble of confidence suggests the widespread popular media coverage of these events have caught consumers' attention. However, in order to get some of their courage back, consumers are directed to "the second page of the newspaper, below the fold." Here, they will find more encouraging news about the economy. For example, industrial production rose for the sixth consecutive month in June 2002. Consumer inflation of 0.1% in July 2002 barely showed on the economic radar screen. Business inventories rose 0.2% in May 2002. The housing sector is on pace for having its best year since the 1980s.

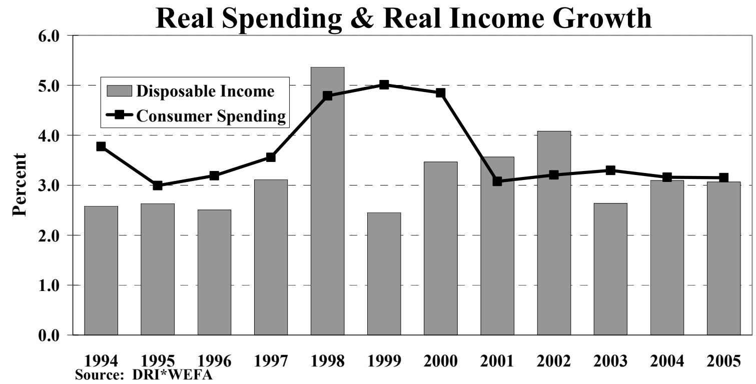
This sets the stage for slightly accelerating growth during the forecast period. Specifically, real GDP, the most-watched indicator of the economy's overall health is forecast to advance 2.5% this year, 3.5% next year, 3.7% in 2004, and 3.1% in 2005. Real consumer spending should grow just over 3.0% per year. Spending on the military and homeland defense should cause federal government spending to grow faster than real GDP in both 2002 and 2003. And after declining for two straight years, real nonresidential fixed investment is expected to begin growing again in 2004. During this expansion, inflation should remain modest, averaging about 3.0% per year after this year.

This is not to say the economy's future will be without risks or challenges. The biggest drag on the economy in the near future will be the trade deficit. Since 1991, the real net export deficit has bloated from under $16 billion in 1991 to just under $500 billion in 2002, or about 4.0% of GDP. In fact, it is approaching the point where it becomes burdensome enough to cause a devaluation of the dollar. This forecast accounts for this by assuming the dollar slides 10% over the next two years. In fact, the dollar and euro could be trading at parity by late summer. But even the dollar devaluation should have a positive impact. It will benefit American companies competing in the global market.

Much has been made about the slow job growth during this recovery. Recent modifications to the U.S. economic forecast show this is an area of concern. This is best seen by comparing the current forecasts for real GDP and nonfarm employment to their counterparts from the previous forecast. Real GDP is significantly higher in each year of the current forecast. Thus, one would assume nonfarm employment would also be higher than was forecasted in April 2002. However, the data does not show this; the current nonfarm employment forecast is actually lower than the previous forecast. The reason for this is the current forecast assumes productivity will grow faster. Thus, with higher output per hour, fewer employees will be needed per unit of real output.

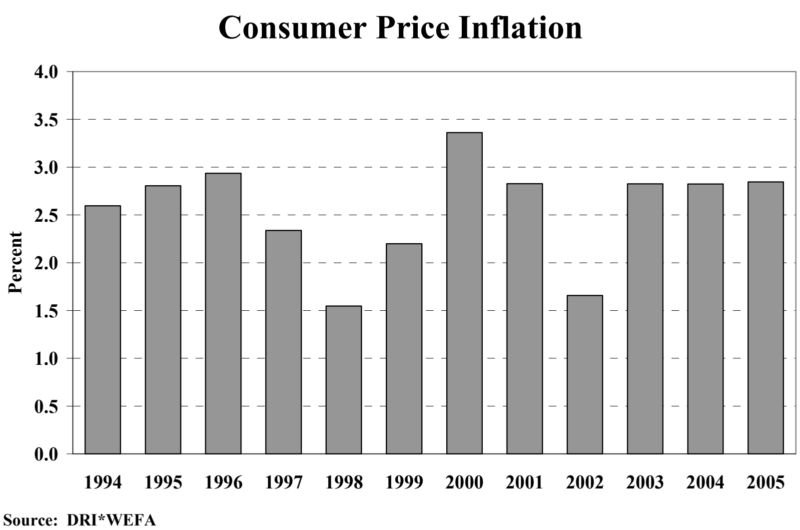
In summary, in spite of these challenges, the national economy is projected to move forward during the forecast period. This is because coming out of the mildest recession on record, the U.S. economy is fundamentally sound and well positioned for growth.

SELECTED NATIONAL ECONOMIC INDICATORS



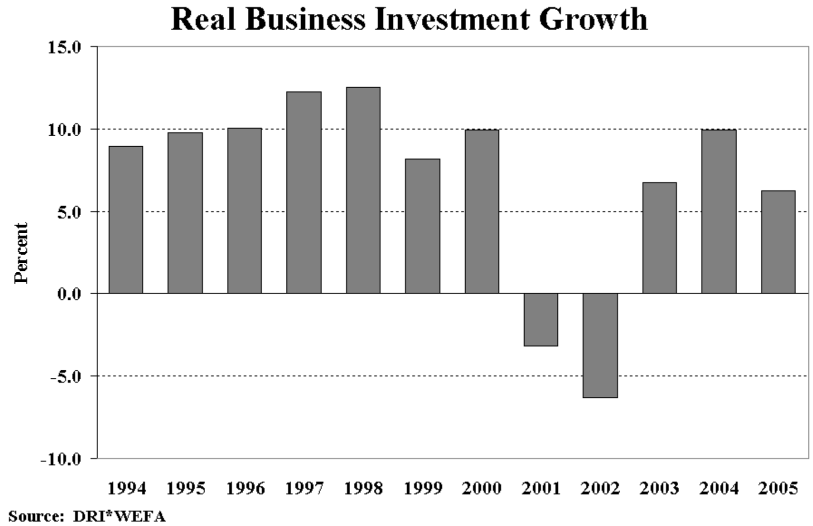
Consumer Spending: Steadfast consumer spending prevented the 2001 recession from being deeper and should help keep the economy afloat over the forecast period. In most cases, recessions result when consumer spending retreats. This is because consumer spending accounts for two-thirds of the U.S. economy. A classic example of this was the 1990-91 recession. Already slowing consumer spending plunged in the last quarter of 1990 and first quarter of 1991. This pulled the economy into a recession that lasted three quarters and caused real output to drop 1.5%. In contrast, real consumer spending has continued to grow during the 2001 recession. (This recession was caused by the collapse in business investment.) The steady consumer spending should make this recession the mildest on record, with a real output decline of less than one percent and a duration of just one quarter. This begs the question of why has consumer held up so well, especially in light of several events that one would expect to undermine consumers' faith in the economy. Over the course of a couple of years, consumers have experienced a major correction in the stock market, rising unemployment, and the terrorist attacks on the U.S. Despite theses events, consumer confidence has remained stubbornly high until very recently. There are several reasons for this. Although the stock market correction had a significant impact on consumers' wealth, it is important to remember this correction came after several years of double-digit market gains that propelled U.S. household wealth to record levels. Thus the decline in wealth was from very high levels, so household wealth remains relatively high. The impact of this market correction was also dampened because consumers spend much less out of wealth than out of income. The terrorist attacks last fall were followed with dire predictions that consumer confidence would collapse and send spending reeling. While there was a significant dip in confidence immediately after the attacks, consumer confidence rebounded stronger and faster than almost anyone had expected. This helped keep spending moving forward. Spending also was aided by generous incentives by automakers and low interest rates. Low interest rates had positive direct and indirect impacts on spending. Purchases of interest rate-sensitive products, such as durable goods, benefited from low interest rates. But they also benefited another way. Low interest rates also fueled the housing market. Once consumers had purchased their new homes, the eagerly filled them with new appliances, carpets, furniture, etc. One of the most significant items affecting consumer confidence is employment. The rapid deterioration of the nation's employment rate, from a low of less than 4.0% to nearly 6.0%, has led to fears that consumers' euphoria will be derailed. Indeed, the employment situation has caused some chinks in consumer confidence. However, any damage will probably be limited. To see why, one must remember that the unemployment rate consistent with a fully employed labor force is currently about 5.5%. The current unemployment rate is just marginally above this threshold. (It should also be noted that the sub-4.0% rate would not be sustainable in the long run and could have eventually led to higher inflation.) Conditions call for steady real consumer spending growth in the future. While job growth has lagged the rest of the economy, it is important to remember this is normal. (The traditional lag between the GDP recovery and job recovery may have been exaggerated in this recession because of the extension of unemployment benefits.) Indeed, there are already signs the employment situation is stabilizing. Once Americans are convinced their jobs are secure, consumer confidence should solidify.

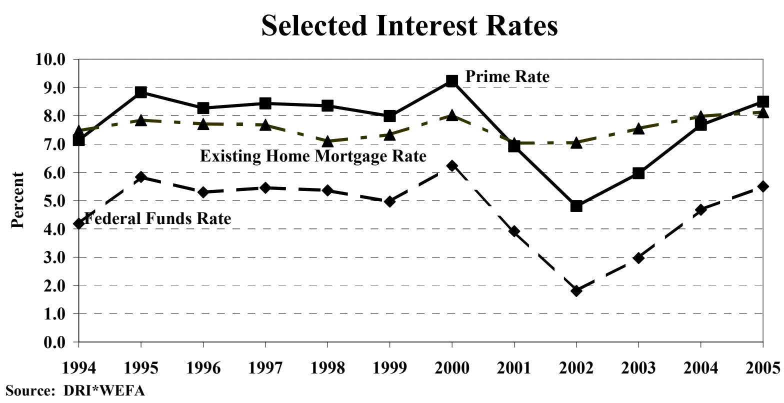
In the meantime, real consumer spending should get a boost from other factors. Interest rates are expected to rise just gradually. And automobile makers have extended their generosity by announcing another round of interest-free loans. A wild card is whether current stock market problems will affect consumer confidence. Even here there is a silver lining. After being pummeled in 2001 and 2002, the stock market is expected to grow again beginning in 2003. Of course, the economy has to get through the short term before it can hit the long term. Consumer confidence is expected to climb to 94 in 2002 and remain near that level for the duration of the forecast. Real consumer spending is anticipated to expand just over 3.0% annually over the forecast period, which is about the expected pace of real disposable income growth. One of the concerns during the late 1990s was that consumers were financing their spending spree with their savings and credit. It will be interesting to see how these two measures fare as the economy grows slower during the forecast horizon.



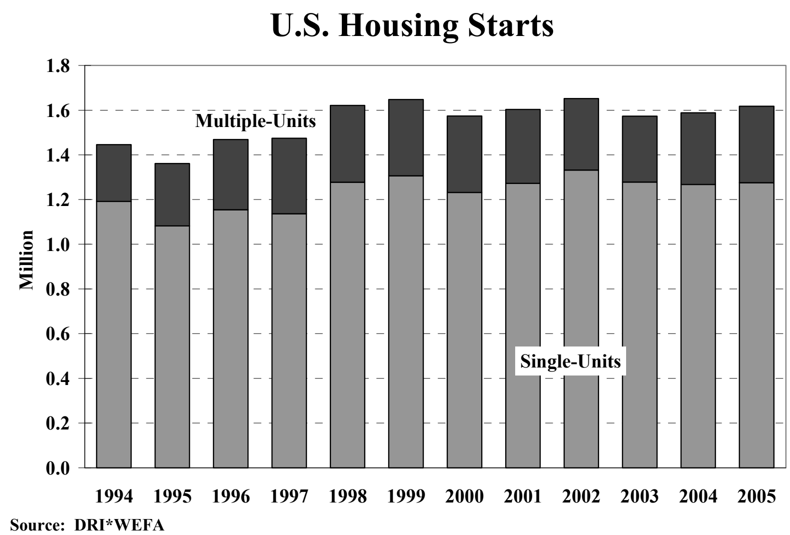
Inflation: Inflation is expected to remain benign over the next few years. This is a relief after the scare the economy suffered in 2000. In that year, Consumer prices jumped 3.4% due to a nearly 30% rise in energy commodity costs. The red-hot economy and even hotter summer temperatures pushed energy prices up significantly. This was felt at all levels of the economy. For example, in 2000, wholesalers saw the price for fuel and power jump nearly 30%. But the huge price increase in this aggregate measure masks even larger changes to some of its components. Specifically, gas fuels, domestic crude oil, refined petroleum products, and residual fuels all experienced price increases over 50% in 2000. As the summer of 2001 approached, the country braced for another round of energy price increases. However, the wholesale price rose just 2% as energy prices were better behaved thanks to the slowing economy and favorable weather conditions. The situation is projected to improve further this year as energy prices at the wholesale level actually retreat 9.3%. This expected decline should cause the energy component at the consumer level to shrink an impressive 7.7% this year. After this year, energy prices are forecast to return to more typical growth patterns that will translate to about 2% annual increases to consumer energy prices at the consumer level. Another recent source of cost-push inflation was increasing employment costs. The strong economic growth in 2000 and 2001 soaked up any excess labor, and this bid up the cost of compensation (wages and benefits). For example, this measure jumped nearly 7% in 2000 and 5.8% in 2001. This was a concern because employee costs are a huge part of business expenses that are ultimately passed on to the consumer. However, the economic slowdown seems to have vented some of these pressures, and employee costs are expected to rise just 2.8% this year. Even after the economy recovers, employee costs are forecast to rise about 4% annually. Rising productivity is a factor keeping the lid on employee costs. Consumer prices should also benefit from the glut of idle manufacturing capacity. This is because businesses cannot raise prices without threatening their market share. Thus, companies should resist price increases unless it is absolutely necessary.

Business Investment: The U.S. Department of Commerce's final estimate for real GDP for the first quarter of this year shows it posted its strongest showing since the last quarter of 1999. Unfortunately, none of it can be attributed to nonresidential investment. This sector has been in a slump since the last quarter of 2000; it has declined in every quarter since that one. The situation is so dire one must look hard to find any bright spots. One could point out that real nonresidential investment dropped at "just" a 6.2% annual rate in the first quarter of 2002, which is about half as slow as the previous quarter's decline. This shaved 0.71 of a percentage point off real GDP growth. A closer inspection of the data reveals some unsettling facts. First, the equipment and software component contributed virtually nothing to real GDP growth in the first quarter of this year, and that is the best news. For over a year it has contracted in each quarter. Second, real investment on nonresidential structures has also been in decline. The disappointing showing for both these components reflect the slowdown in the manufacturing sector, which has been more severe than the overall recession, and the collapse of the dot com industry. The severity of this situation can be seen in the employment and manufacturing capacity utilization data. From the second quarter of 2000 to the first quarter of 2002, the manufacturing sector has shed over 1.6 million jobs. Over this same period, the percent of manufacturing capacity being utilized has fallen from 81.6 % (virtually full capacity) to 73.5%. This glut of manufacturing capacity is one of the factors that should limit any recovery in investment spending. With so much capacity sitting idle, businesses have little incentive to expand. The lack of corporate profits will also put a damper on future business spending. However, low interest rates will help offset some of this impact. Spending on nonresidential structures are expected to be hampered by rising office vacancy rates resulting from the collapse of the dot com industry.



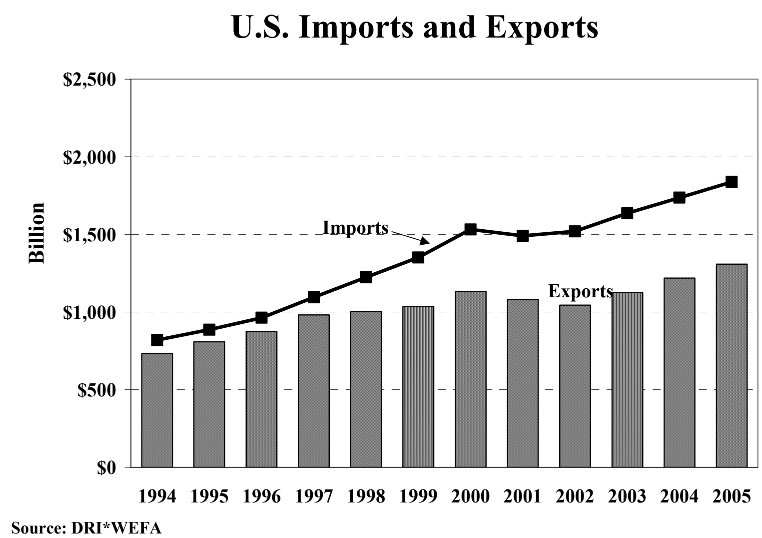


Financial: The Federal Open Market Committee's decision to leave its interest rate targets unchanged was expected by almost everyone. Prior to the Federal Reserve's meeting there was some speculation that the Committee might start raising rates. However, this was the minority opinion. The majority guessed (correctly) that the Federal Reserve would not start tightening until it was sure the economic recovery had legs. At the time of the meeting there still was enough doubt about the recovery's health to tilt the scales in favor of the central bank holding the line on interest rates. The Federal Reserve's wait-and-see policy is also being shaped by the inflation situation. Without the pressures of raging inflation, the central bank has been afforded the luxury of time to set its policy. However, upward pressures on inflation rates are coming from other sources. Following three years of net debt redemption, the Treasury has had to resume raising new cash. In early May 2002, the Treasury auctioned off $33 billion in notes. Two-thirds were five-year notes and the remainder was ten-year notes. There was investor interest in these notes, but there was no mad dash for them. The five-year notes sold at a yield of 5.17%, which was the highest of the year. Interest rates go up if the Federal Reserve feels compelled to boost the flagging dollar. Over the last few months the greenback has tumbled because it has lost favor with foreign investors. This slide reflects the impacts of both political and economic factors. On the political front, tensions in the Mideast intensified, while the saber rattling between Pakistan and India threatened to escalate into a shooting war. High-profile international condemnation of protectionist U.S. trade policies has also likely hurt the dollar. On the economic front, the frustrating performance of the U.S. stock market has led foreign investors to slow their net purchases of stocks and bonds. Despite pressures on the dollar, it is believed the Federal Reserve will keep its focus on economic growth and inflation. As a result, it will raise rates slowly beginning in the second half of this year. The federal funds rate should average about 2.0% this year, 3.0% next year, 4.7% in 2004, 5.5% and 2005. The discount rate is projected to be a percentage point higher than the federal funds rate in the last three years of the forecast. The real exchange rate is expected to decline through the forecast period.



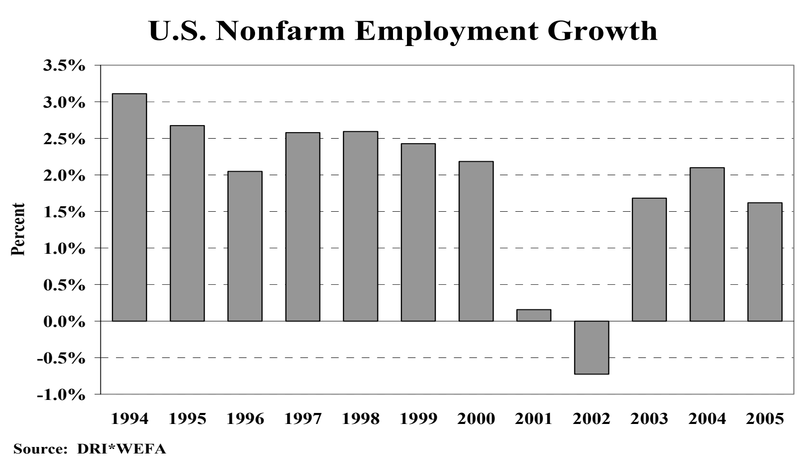
Housing: Housing has been a notable exception to the dismal investment picture. For example, total the number of housing starts grew in 2001 and it is expected to expand further this year. Not only have starts been growing, but so have housing sales. Another positive sign is real spending on residential structures grew at a 14.6% annualized rate in this year's first quarter. But this probably has more to do with the mild winter weather than economic factors. Housing starts follow relatively predictable seasonal patterns. Typically, as winter moves in, housing starts drop. To adjust for this, factors are developed and used to adjust the raw data to compensate for seasonal patterns. This is done so any remaining changes are mainly due to economic factors. The seasonal factor for housing achieves this by boosting the winter raw housing start data. But this winter has not been typical; it was the mildest on record. As a result, the decline in the raw data that usually took place did not occur. However, the raw data was increased by the seasonal factor, which is why housing starts were so strong in the first quarter of this year. Had the winter been more typical, U.S. housing starts would have been lower. However, the positive impact of the lowest mortgage interest rates in a generation cannot be ignored. The number of U.S. housing starts is expected to rise 3.1% this year, retreat 4.8% next year, grow 1.0% in 2004, and expand 1.8% in 2005.

International: The nation's trade situation is projected to deteriorate over the forecast period. This is much different from the 1990-91 recession were trade was actually improving and counteracted some of the other negative factors at that time. Since that time, the real net export deficit has bloated from under $16 billion in 1991 to just under $500 billion in 2002. Ironically, this deficit results from the nation's economic strength in recent years. Up until recently, the U.S has been the world's economic locomotive. As other economies lost steam, they looked to the U.S. as the economic engine that would pull them forward. This arrangement favored imports of goods into the U.S. compared to U.S. exports. The strong dollar reinforced this situation. Thus, the trade sector was actually a drag on the entire economy over these years. However, this fact seems to have gone unnoticed because, even with the



trade drag, real output was expanding at well above trend levels. But as the economy has slowed, the trade deficit is once again being scrutinized. Unfortunately, anticipated conditions show the trade deficit should grow even larger over the forecast period. The rest of this section focuses on the anticipated performances of several of this country's trade partners. Canada's economy is projected to growth faster than the U.S. economy over the next two years. One of the reasons our northern neighbors enjoy stronger growth is because its federal government and several provinces enacted tax reductions before the U.S. In addition, Canada's economy is less dependent on the high-tech sector than the U.S. economy, so it was less impacted by the collapse in business investment. To our south, the Mexican economy has been in recession for more than a year because of weak demand for its products both home and abroad. This downturn, while relatively mild, has been one of the longest in the last two decades. However, several indicators suggest the economy has turned the corner and is entering an expansionary cycle. This being the case, the Mexican economy should grow faster than its U.S. counterpart over the forecast period. Japan's seemingly chronic recession should show signs of clearing next year. However, its recovery is expected to be weak and lag U.S. economic performance for the next few years. The combined outlook for the large West Europe countries (France, Germany, U.K., and Italy) is similar to Japan's. After growing faster than U.S. output in 2001, European real GDP should grow slower than U.S. real output.

Employment: What goes up usually comes down. But in the case of the U.S.unemployment rate, after a rapid rise it is falling slowly and is not expected to land at its previous low. The U.S. civilian unemployment rate hit a low of 3.9% in April 2000. It was at 6.0% exactly two years later, one year after the 2001 recession officially started. The unemployment rate of 5.9% in June 2002 was a marginal improvement. Unfortunately, it does not appear that the unemployment rate will retreat to anywhere near its previous low over the forecast period. The civilian unemployment rate is projected to average 6.0% this year. It is expected to average 5.1% in 2004. Thus after two years, the unemployment rate will have improved by just under 100 basis points and it will still be 1200 basis points above its 2000 trough. The less-than-spectacular reduction in the unemployment rate is a concern because it has such a heavy influence on consumer confidence. Should Americans grow impatient with the pace of the employment recovery, consumer confidence could retreat. This is not expected to happen because, believe it or not, the employment situation is not as bad as been portrayed in the media. This recession has had a relatively mild impact on employment. In fact, this will be the only post-World War II recession where the unemployment rate fails to top



7.0%. It peaked at 7.8% as a result of the 1990-91 recession. The current unemployment rate of 5.9% is relatively low compared to the last two decades. It averaged 5.8% through the 1990s and was an even higher 7.3% through the 1980s. Not everything is better this time, though. The duration of unemployment is running longer than usual. In June 2002, the average length of unemployment was 17.3 weeks, which was about a month longer than in the previous June. Part of this increase reflects the emergency extension of unemployment benefits. As was mentioned above, the unemployment should not fall back to its 3.9%-trough during the forecast period. But this is not a bad thing. The return to a 3.9% unemployment rate may be undesirable because economists believe the economy is at full employment when the unemployment rate is around 5.0%. Below this level, employee compensation costs start to heat up and inflation becomes a problem. Neither can the unemployment rate remain near 6.0%. Many businesses have also pared employment to minimal levels, and will need to increase payrolls as the economy reheats. This should cause the unemployment rate to gradually fall back to 5.1% in 2004—the full-employment level, which is consistent with the long-term health of the economy.